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July 30, 1999

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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Re: *Ex Parte* Comments of AT&T Corp. & MediaOne Group, Inc.
MM Docket No. 92-264 (Horizontal Ownership Limits)
CS Docket No. 98-82 (Cable Attribution Rules)

Dear Ms. Salas:

AT&T Corp. ("AT&T") and MediaOne Group, Inc. ("MediaOne") submit this *ex parte* letter to address a recent development -- AT&T's proposed acquisition of MediaOne -- that underscores the fundamental point made by both companies in comments filed in the above-captioned proceedings.¹ The proposed acquisition focuses attention on the fact that upgraded cable systems are capable of providing multiple services, including competitive local telephony, and that cable regulations developed in the isolated environment of video have the potential to frustrate the development of advanced cable networks and the deployment of these services. In particular, a rule prohibiting a single cable operator from having controlling or minority interests in cable systems that pass more than 30 percent of the nation's cable homes would undermine the fundamental objective of the Telecommunications Act of 1996 (the "1996 Act") -- and the strategic driver of AT&T's cable investments -- to bring about local telephone competition. And, as the attached Public Interest Showing demonstrates, such a rule could have that

¹ In order to assist the Commission in its deliberations in these two proceedings, AT&T/MediaOne attach hereto, and requests inclusion in the record of the horizontal ownership and cable attribution proceedings, the "Description of the Transaction, Public Interest Showing and Related Demonstrations," filed in *Transfer of Control of FCC Licenses from MediaOne Group, Inc. to AT&T Corp.* (filed July 7, 1999) ("Public Interest Showing").

anticompetitive effect without in any way furthering the video programming competition goals that motivated Congress to adopt the horizontal cable ownership limits.

Notwithstanding Congress' and the Commission's efforts to encourage local telephony competition, incumbent local exchange carriers ("ILECs") retain monopoly control over local exchange and exchange access service areas nationwide. Although competition for the largest business customers is beginning to develop in some urban areas, competition for residential and small business ("mass market") local exchange and exchange access service has been virtually non-existent.²

AT&T is committed to reversing this situation and ensuring that "residential local exchange competition becomes a reality sooner rather than later."³ In addition to the assets committed to the acquisition of TCI and its proposed acquisition of MediaOne, AT&T has committed to invest billions of dollars of shareholder assets to upgrade its networks to provide facilities-based local telephone competition. As the Commission has recognized, "AT&T is one of only a few firms that currently possesses the experience, brand name assets, and financial resources that are essential for quick and substantial entry into the retail residential local exchange and exchange access markets."⁴

However, as explained in the attached Public Interest Showing, in order to provide local telephony competition on a broad scale, it is critical that AT&T acquire the facilities of MediaOne. By combining its strong telephony brand, sophisticated knowledge of marketing telephony services, and technical expertise in establishing and managing telephone networks, with MediaOne's cable systems, AT&T will be able to provide an alternative to the ILECs' services for residential customers far more quickly and effectively

² Memorandum Op. and Order, *In re Application of Teleport Communications Group, Inc., Transferor, and AT&T Corp., Transferee*, 13 FCC Rcd. 15236, at ¶ 24 (1998) (ILECs "are the sole actual providers of local exchange and exchange access services to the vast majority of residential and small business customers in most areas of the United States.").

³ Memorandum Op. and Order, *Applications for Consent to Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor, to AT&T Corp., Transferee*, 14 FCC Rcd. 3160, at ¶ 48 (1999) ("AT&T-TCI").

⁴ *Id.* at ¶ 47.

than either company could separately.⁵ In fact, by acquiring MediaOne, AT&T will gain *immediate* access -- and the ability to provide competitive, facilities-based local exchange services -- to millions of consumers in service areas where it currently has no facilities and cannot provide competitive local telephony.⁶

Moreover, the acquisition of MediaOne is critical to enable AT&T to spread the enormous investment required to deploy cable telephony to a wider customer base. As demonstrated in the Public Interest Showing, deployment of cable telephony requires a large fixed investment in the development of engineering protocols and operating standards and practices; construction and furnishing of central offices, transport facilities, and databases; hiring and training of installation and maintenance crews; and establishment and staffing of customer care centers. Similarly, the costs of marketing new services to residential consumers are substantial. The economies that AT&T will achieve as a result of its acquisition of MediaOne are particularly important because, although the acquisition will give AT&T a "footprint" roughly the same size as an Ameritech-SBC-PacBell, AT&T for several reasons will begin with many *fewer* customers than such an ILEC. First, cable

⁵ MediaOne has faced a number of obstacles in developing competitive local exchange telephony, including lack of brand recognition (and, accordingly, consumer confidence), lack of telephone network management expertise, and the absence of telephone marketing and customer care service expertise. Thus, MediaOne today has only approximately 26,000 telephone customers and a penetration level of less than 3 percent of the homes ready for its telephone service, despite having invested approximately \$4.1 billion to upgrade its system to provide telephony. *See* Public Interest Showing at 21-24.

⁶ The benefits of local telephony competition could not be achieved without the acquisition. This is so primarily because attempts to contract with MediaOne to allow AT&T to lease its facilities to provide cable telephony would be much less efficient than full integration when the parties are trying to deal with rapidly evolving technologies and service. This is particularly true where, as here, there is technology and service convergence -- no one can predict very far into the future what technologies and services are going to develop increased demand and what that means for efficient allocation of cable bandwidth. Without knowing the answers to these questions, potential joint venture partners have difficulty resolving issues such as how much bandwidth would be reserved for services to be provided by one joint venturer and how much bandwidth would be reserved for services to be provided by the other joint venturer. *See* Public Interest Showing at 31-32.

and telephone service have dramatically different penetration rates: on average, 94 percent for telephone and 65 percent for cable television. Thus, even when a cable company passes as many houses as a telephone company, it has almost 30 percent fewer customers. Second, as a new entrant into telephony, cable companies start with *no* telephone customers. Third, cable companies must expend enormous sums of money to research, develop, and implement broad scale cable telephone networks while ILECs already have ubiquitous, working networks in place.

Under these circumstances -- where Congress has placed such a heavy emphasis on the development of local telephone competition and the ability of AT&T to expand its ownership of cable systems is so obviously critical to achieving that goal -- it is imperative that the Commission reexamine its suspended horizontal ownership rules from this broader perspective. In particular, AT&T/MediaOne recommend that the Commission make at least the following changes: 1) consistent with the underlying purposes of the rules, attribute to an MSO only those cable systems for which the MSO actually does or could control programming choices or purchase programming; 2) consistent with the Commission's proposal in the *Further NPRM*, measure an MSO's horizontal concentration level as a percentage of all MVPD subscribers; and 3) significantly raise the 30 percent limit. These changes would allow the Commission to satisfy the underlying purposes of the horizontal rules without sacrificing the enormous benefits in terms of local telephony competition that AT&T and other companies could achieve through increased cable system ownership.

Congress enacted the cable horizontal ownership limit based on the concerns that cable operators could: (1) exercise monopsony power to force unfair concessions from programmers;⁷ and (2) vertically foreclose entry by programmers, thereby reducing program diversity.⁸ Thus, as the Commission has acknowledged, the purpose of the

⁷ See H.R. Rep. No. 628, 102nd Cong. 2d Sess. 42-43 (1992) ("[T]he size of certain MSOs could enable them to extract concessions from programmers, including equity positions, in exchange for carriage.").

⁸ See S.Rep. No. 92, 102nd Cong, 1st Sess. 32 (1991) ("[T]here are special concerns about concentration of the media in the hands of the few who may control dissemination of information ... and will slant information to their own biases or ... provide no outlet for unorthodox or unpopular speech because it does not sell well, or both.").

horizontal ownership limit relates entirely to the ability of cable operators adversely to affect programming competition and diversity.⁹ As the attached Public Interest Showing makes clear, AT&T's proposed acquisition of MediaOne implicates neither of those concerns.

As an initial matter, existing and growing competition from non-cable MVPDs, which serve as alternative outlets for video programming, sharply constrains (if not eliminates) the ability of any cable operator to engage in conduct that would be harmful to the programming business. As demonstrated in the Public Interest Showing, MVPD competition has grown rapidly in the nearly six years since the horizontal rules were adopted. Consider, for example, that DBS had not even been launched when the rules were adopted and today two of the seven largest MVPDs are DBS companies, DirecTV and Echostar. DBS is growing 20 times as fast as cable (and winning two of every three new customers when competing against cable), obtaining exclusivity rights to valuable sports and entertainment programming, partnering with powerful ILECs to market programming locally, and aggressively entering the Internet access business. It is no wonder that the Justice Department recently found that "consumers view [DBS and cable] as similar and to a large degree substitutable."¹⁰ Other MVPDs, including the ILECs, utilities, SMATV, C-band, and MMDS, provide further competition to cable.

The growth of DBS and other competitors to cable means that programmers now have meaningful alternative outlets for distributing their product. The presence of these alternatives, and the fact that they are growing much more rapidly than cable, necessarily

⁹ See Second Report and Order, *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992*, 8 FCC Rcd. 8565, at ¶ 10 (1993) ("Congress concluded that [the] degree of [cable] concentration, though low relative to other industries, may enable some MSOs to exercise excessive market power, or monopsony power, in the program acquisition market. Congress was concerned in particular with preventing large vertically integrated cable systems from creating barriers to entry for new video programmers, and from causing a reduction in the number of media voices available to consumers.").

¹⁰ Complaint, *United States v. Primestar, Inc.*, No. 1:98CV01193, at ¶ 63 (D.D.C. May 12, 1998). It is also worth noting that under the Communications Act a cable franchise is deemed competitive if 15 percent of the subscribers in the franchise area get their programming from a non-cable MVPD, and today, on a national basis, 16 percent of all subscribers get their programming from a company other than their cable operator.

reduces any MSO's power to foreclose rival programmers or to obtain unfair concessions from programmers. As the Commission recently observed, "[w]ith the growth of alternative MVPDs, network programmers gain alternative avenues for distribution of their products, thus reducing cable operators' market power or influence in the purchase and distribution of network programming."¹¹

In light of the dramatic growth in MVPDs other than traditional cable systems, and consistent with the statutory purpose underlying the ownership limit, it would be arbitrary and irrational for the Commission to retain an ownership rule that fails to take account of all MVPDs. Rather, the Commission should amend the suspended rule to measure a cable operator's horizontal concentration level as a percentage of all MVPD subscribers. The suspended rule, based on cable homes passed, completely ignores the considerable increase in the number of subscribers served by competing MVPDs, most importantly DBS, so that it vastly overstates an MSO's ability to engage in vertical foreclosure or to exercise monopsony power.¹² Indeed, the Commission already has proposed to adopt an MVPD subscriber test in the *Further NPRM*.¹³ AT&T/MediaOne fully support that proposal.

Moreover, in analyzing the ability of an MSO to foreclose rival program services or to obtain anticompetitive concessions from programmers, the only relevant systems are those for which the MSO controls programming choices or buys programming. If an MSO cannot force a cable system to decline to carry a rival program service, then the system is irrelevant to that MSO's ability to pursue a vertical foreclosure strategy. Similarly, an MSO derives no power to force anticompetitive concessions from a programmer based on a cable system for which it does not purchase programming, even if the MSO has a minority interest in the system. Thus, it is perfectly consistent with the underlying purposes of the horizontal ownership statute for the Commission to attribute to an MSO

¹¹ Memorandum Opinion and Order on Reconsideration and Further Notice of Proposed Rulemaking, *In the Matter of Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 - Horizontal Ownership Limits*, 13 FCC Rcd. 14462, at ¶ 80 (1998) ("*Further NPRM*") (emphasis added).

¹² Moreover, AT&T/MediaOne believe that it is virtually impossible to define or quantify homes passed. See Public Interest Showing at n. 153.

¹³ *Further NPRM*, at ¶ 79 (1998).

only those cable systems for which the MSO controls programming choices or purchases programming.¹⁴

AT&T/MediaOne also urge the Commission to raise the 30 percent limit. Again, the growth of competitive alternatives to cable, particularly DBS, has directly and substantially reduced the theoretical concerns that cable operators could exercise monopsony power or engage in vertical foreclosure to the detriment of the program marketplace.¹⁵ Therefore, the Commission can significantly relax the cable ownership limit without being concerned that this will lead to anticompetitive behavior by large cable operators.¹⁶

Finally, AT&T/MediaOne would like to emphasize once again that the approaches to the suspended horizontal rules described in this letter are crucial to its ability to expeditiously provide facilities-based local telephony services in competition with the

¹⁴ As noted in the Public Interest Showing, after the Merger, AT&T will be involved to some extent in the purchase or selection of programming for cable systems with approximately 26.6 percent of current MVPD subscribers (23.7 percent after the Falcon Communications, L.P., Bresnan Communications Co., Ltd. Partnership, and Cox Communications, Inc. transactions are completed). Market shares of this size raise no conceivable concern that AT&T could exercise monopsony power or engage in vertical foreclosure under traditional measurements of market power. *See* Public Interest Showing at 55-60. Nor is there any concern that the proposed acquisition of MediaOne will reduce program diversity. *See id.* at 64-65.

¹⁵ In addition, concerns that a cable operator could impair the programming marketplace are already largely foreclosed by existing regulations, such as the program access, program carriage, must carry, leased access, and channel occupancy rules, which address the very same behavior targeted by the horizontal limit. The Commission has recognized that because these rules "all affect the way the cable television industry currently operates and have a profound effect on current industry structure and performance," it is appropriate "to consider the impact of these provisions in alleviating some of the public interest and anticompetitive concerns about horizontal concentration." *Further NPRM* at ¶ 50.


¹⁶ It is worth noting, in this regard, that in the 1996 Act Congress raised the national broadcast limit from 25 percent to 35 percent.

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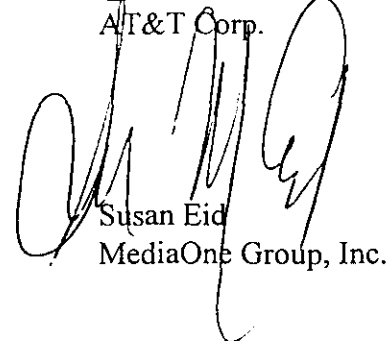
ILEC monopolies. That fact should guide the Commission as it considers its horizontal rules. Congress spoke most clearly in the 1996 Act about its paramount desire to inject competition into local telephony. The Commission should adopt an approach to cable horizontal ownership that enhances rather than reduces the chances of achieving that goal. Purely theoretical concerns about monopsony and vertical foreclosure provide no basis to deprive a significant number of American consumers of the actual benefits of a vibrant competitor to their local telephone provider.

AT&T and MediaOne look forward to working with the Commission on these issues. Please do not hesitate to contact us if we can be of any assistance.

Sincerely,



Joan Marsh
AT&T Corp.



Susan Eid
MediaOne Group, Inc.

cc: Deborah Lathen
Quyen Troung
Darryl Cooper
Sunil Daluvoy

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